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Arresting slowdown in economy-strategies for turn around

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Abstract

The current scenario in India is not better than a sinking ship. The continuous fall in rupee, the slow growth rate of a decade and the inflation are signs to doming economy. The challenges in front of the Indian economy are many and needs to be worked upon immediately before it reaches a state of irreversibility. There are various ways of looking at India's present economic woes marked by a rapid fall in the value of the rupee caused by persistent inflation of the past few years and the high current account deficit (CAD) of about $85 billion (4.5% cent of GDP) which needs to be funded through uncertain capital inflows year year after year. The description of the present crisis by various economic and political analysts by itself tends to carry shades of ideological bias. Some well known economists on the right prefer to describe the external sector situation as worse than the 1991 economic crisis India had faced. This narrative suggests the 1991 crisis was marked by a severe, external sector crunch and it acted as a trigger for the big bang reforms of the early 1990s. This section believes that the present crisis may be worse than that of 1991 but the government this time round is much more complacent, and less inclined to implement drastic reforms to revive growth. The study was based on secondary data.

Key words: Current account deficit, GDP, Indian economy, economic crisis

Introduction

Of course, not everyone agrees with the narrative that the India of 2013 is worse than it was in 1991. Actually it is not. And more of the same kind of reforms is perhaps not the answer either. The world was very different in 1991 when western economies were still strong and looking outward, trying to deepen the process of economic globalization. Today, major OECD economies are looking much more inward than before, trying to fix their own domestic economic and polity. Emerging economies like India, which managed to avoid until 2011 the negative impact of the global financial crisis, began to dramatically slowdown after 2011. Most of the BRICS economies have lost over four per cent off their peak GDP growth rates experienced until 2010.

After 2010, excess global liquidity flowing from the West, the consequent high international oil and commodity prices fed seamlessly into India's domestic mismanagement of the supply of key resources such s land, coal, iron ore and critical food items to create a potent cocktail of high inflation and low growth, and a bulging CAD.

The key difference between 1991 and 2013 is the availability of global financial flows. In 1991, western finance capital had not significantly penetrated India. Now, a substantial part of western capital is tied to India and other emerging economies where OECD companies have developed a long- term stake. The broader logic of the global capital movement is that it will seamlessly move to every nook and corner of the world where unexploited factors of production exist and there is scope to homogenize the modes of production and consumption in a global template. This relentless process may indeed gather steam after the United States shows further signs of recovery.

The Indian economy suffered its words slowdown in almost a decade, with the country even facing the ignominy of a ratings downgrade, which was salvaged somewhat with some hasty but big-ticket reforms in the latter part of the year. A downgrade of India's sovereign rating, already a tad above unstable, would have dealt a further major blow to the economy by assigning junk status to the country's external borrowings.

This would have forced multinational corporations to freeze their capital flows, making foreign funds to withdraw from the country's capital markets and depreciating the rupee to a level that could have sent fuel prices to untenable levels. The perception of policy paralysis was sought to be changed with the Central Government pursing a series of reforms, notably on the initial steps to allow global chains like Wal-Mart, Carrefour, Tesco and JC Penny to set up shop in the country. It is now up to individual State Governments to follow suit though 13 out of 28 have said no.

An overview of the Indian Economy

The country's gross domestic product (GDP) growth fell to nine-year low of 5.3% in the January-March 2012 quarter. It improved marginally to 5.5%, but fell again to 5.3% in the July-September period. The average economic growth of 5.36% in the first three quarters of 2012 is sharply lower than the average annual growth of 8.2% recorded in the past eight years.

It is a truth well acknowledged that ramp up in capital spending and infrastructure goes a long way in taking a country's growth to the next level. This was quite evident in India as well. Indeed, there were many reasons why India's GDP growth soared between 2003 and 2008. One of these was that capital spending by private firms rose in that period from 10% to 17% of GDP.

India's economy has slowed remarkably in the past two years-from 9.3% in FY11 to 5% in FY13, the weakest in a decade. This has raised marked concerns about a prolonged economic slowdown. With market concerns about high bank non-performing loans and limited room to ease interest rates, consensus expectations are for a sluggish growth outlook continuing in FY14.

Inflation adversely impacts the poor more than the rich or the middle classes and results in the indirect transfer of resources from the worse-off to the better-off sections of the population. When inflation is driven by high food prices as it has in India in recent years, the deleterious consequences are magnified since the economically underprivileged spend half or more of their incomes on food.

The gravity of any crisis facing a nation can often be judged by the one to which it is being compared.

In the US, the peak of the 2008-09 global financial crises saw references made to the Depression of the 1930s.

Over in Greece, the country debt problems in recent years triggered comparisons with Argentina's default back in 2001, which at the time was the biggest sovereign default in history.

In India's case, its recent economic issues have sparked talks of a repeat of the situation it faced in 1991, often considered its worst economic crisis.

The crisis saw its currency tumble and its foreign exchange reserves depleted. Things turned so bad that India eventually had to be rescued by the International Monetary Fund.

Growing Problems

One of the key areas of concern is India's burgeoning current account deficit, which hit a record high of 6.7% of gross domestic product (GDP) last year.

The Indian rupee has fallen more than 20% against the US dollar since the start of the year 2013. That has made India's imports more expensive and added to the country's economic problems. India's economy grew by 4.4% in the April-Jun quarter of 2013. The US economy expanded at an annualized rate of 2.5% in the second quarter.

2012 was a dull year property markets. Price appreciation in this year slowed with the top 7 cities witnessing a rise of only 1-3%.

India Gross Domestic Product (GDP) grew at 4.8% in the fourth quarter of FY13, marginally lower than an estimate of 4.9%. This is a marginal improvement over the Q3 GDP growth rate of 4.7%.

The GDP for the entire FY13 grew at 5%, which is a decade low number. The manufacturing sector of the economy grew at 2.6%.

India's economic growth was at 6.2% for the 2011-12 fiscal. It had grown by 5.4%, 5.2% and 4.7% in the first, second and third quarters, respectively, of 2012-13, according to data released by the Central Statistical Organizations (CSO).

During 2012-13, the sector under review grew by a meager one per cent compared to 2.7% in the previous fiscal. Mining and quarrying sector contracted by 3.1% during the fourth quarter of last fiscal, as against growth of 5.2% in output in the same period of 2012-13. The contraction in mining sector remained unchanged at 0.6% in 2012-13 over the previous fiscal. Farm sector output expanded by just 1.4% in January-March this year, as against 2% in the same quarter of 2011-12. The agriculture sector also grew at a slower rate of just 1.9% in 2012-13 compared to 3.6% in 2011-12.

Major Factors for Sudden Slowdown of Indian Economy are

1. Ineffective Monetary Policies

To treat the problem of inflation as largely a monetary policy issue and by placing a great onus on the Reserve Bank of India to curb inflation by containing liquidity, the government has simplistically followed textbook notions of checking "too much money chasing too few goods". Food inflation has been primarily driven by supply constraints.

2. Weakening Rupee

The depreciation in the value of the Indian rupee vis-a-vis the US dollar is a consequence not only of external factors but also of the country's imports growing faster than exports resulting in the trade deficit jumping by 56% between 2010-11 and 2011-12.

The deficit has sharply widened because imports-more than half of the country's import bill is accounted for by two items, crude oil and gold-are inelastic and export growth has been sluggish. India's export markets in the West have disappeared or shrunk drastically on account of the Great Recession while many of the country's exportable products are still not sufficiently competitive in Asian markets.

3. Oily Mess

The country's petroleum sector is in a state of chaos. It is claimed that petrol prices have been decontrolled but public sector oil refining and marketing companies like Indian Oil Corporation do not increase prices without a nod from the government.

4. Crony Capitalism

The ugly underbelly of the policies of economic liberalization followed over the last two decades has been crony capitalism at its worst. The most prominent of Indian industrialists have emulated some of the worst practices of Russian and Chinese oligarchs in the manner in which they have successfully influenced government policies and systematically subverted the rule of law.

5. Misutilization of Natural Resources

The second-generation (2G) spectrum scam epitomizes the manner in which the Union government, which is supposed to act as a custodian of natural resources that belong to the people of the country, has failed to perform its functions in a prudential and impartial manner.

Instead of ensuring transparency in the manner in which natural resources are valued and allocated, government policies have been opaque and less than fair resulting in a plethora of allegations of corruption and nepotism.

6. Reluctant Regulation

The misutilisation of natural resources has been facilitated by reluctant regulators, who were typically former bureaucrats and who were often selected for their subservience to their political masters. From financial markets to electricity distribution, the government did not deliberately empower regulatory authorities in the wake of economic liberalization thereby offering wide windows of opportunity to crony capitalists to milk the system and earn super-normal windfall gains. The regulatory bodies became sinecures to park loyal babus after they retired.

The government did away with the Monopolies and Restrictive Trade Practices Commission with alacrity but failed to expeditiously empower the Competition Commission that could check abuses of market dominance.

7. Politics-Crime-Business Nexus

The combination of crony capitalism, reluctant regulation and misutilisation of natural resources has manifested itself in the ugly nexus among corrupt politicians, criminals and businesspersons. No one symbolises this nexus better than Gali Janardhana Reddy, former Minister for Tourism, Infrastructure Development and Youth Affairs in the government of Karnataka led by B.S. Yeddyurappa.

8. Political Paralysis

Instead of focusing on reforms for the health-care and education sectors and proper delivery of subsidies to assist the fourth of the country's population whose conditions are worse than those who live in Sub-Saharan Africa, the government has tried to bring about contentious policy changes-such as allowing foreign investments in multi-brand retail outlets-that elude a consensus within the ruling coalition, leave alone the entire political class.

9. Inflation Monster

Inflation has shot up to 8.43% in December as against 7.48% in November. Food inflation remains stubbornly high at 16.91%. Needless to say, markets have already felt jitters based on concerns emanating from this prime culprit.

Suggestions to Improve India's Economy

To revive growth in the short run, India must improve supply, which means shifting from consumption to investment. And it must do so by creating new, transparent institutions and processes, which would limit adverse political reaction. Over the medium term, it must take an axe to the thicket of unwieldy regulations that make businesses so dependent on an agile and cooperative bureaucracy.

To get through the situation following measures can be suggested-

1- Reduction in subsidies, insurance and pension sector reforms, implementing GST to restore growth and required states to come to an agreement.

2- Provide strong push to exports by widening the focus market and product scheme.

3- Focus on economic growth to attract investment.

4- Confidence building to prime requirement as present markets are nervous and fragile.

5- Bring back the lost competitiveness due to an appreciation of real effective exchange rate of rupee.

6- Increase oil imports from Iran which accepts total payment in rupees and who are large dollar buyers.

7- China is India's biggest trading partner, China alone accounts for half of non-oil trade deficit. This bilateral deficit can be an offset by capital inflows from China to India's infrastructure.

8- Sell gold bond with 5 year maturity which is an exact gold substitute.

9- Urgent need to preview manufacturing growth. Create right set of policies to improve technology and increase value addition within country, thus enabling reduction of imports and increase in exports and employment.

10- Government should change its policies from socialism to capitalism. Government should invest public's money only in items which are essential and leave the private sector take care of business. It should look forward for benefit of consumers and not become supplier.

We have an economist captaining the ship of democracy in India, he has in the past been at realm of affairs during the 1991 crisis. There is still hope as the fundamentals of our economy are strong but building on them needs more than will it needs deeds and sacrifices.

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